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SUBJECT: TOP CHINESE ECONOMIST ON ECONOMY, POLITICAL REFORM

Classified By: AMBASSADOR CLARK T. RANDT, JR. REASONS: 1.4 B and D

¶1. (C) SUMMARY. In a December 22 dinner hosted by Ambassador Randt, Economic Leading Group Vice Minister Liu He said the Chinese leadership's top concern over China's economic slowdown is that it will spark instability in China's urban centers. Liu, one of the key economic advisors to the Party leadership, added that some leaders at the recent Central Economic Work Conference had argued for policies targeting the rural sector, but the final consensus was to direct economic stimulus measures at ensuring employment in the cities. Liu predicted that China's worse-than-expected fourth quarter 2008 economic performance would cut China's overall GDP growth rate to 8.5 percent this year, and that the first quarter of 2009 would be worse. China's leadership expected China's economy to slowly recover in the last half of 2009 and allow China to achieve its target of 8 percent GDP growth for the year. While China's near-term focus would be economic stability, Liu noted that he and other younger leaders understood China's long-term success would require political reform. END SUMMARY.

¶2. (C) In a private dinner hosted by Ambassador Randt on December 22 for leading Chinese economist and Vice Minister Liu He, Liu described his views and those of China's leadership on China's economic challenges in the coming years. Educated at People's University with graduate work at Seton Hall and Harvard Universities, Liu is widely viewed as China's most influential third generation economist. Most notably, Liu is Deputy Director of China's Central Leading Group for Financial and Economic Work, which is the Chinese Leadership's premier advisory body for economic policy.

Economy Slowing Rapidly, but Worst is Yet to Come

¶3. (C) VM Liu told Ambassador Randt that China's worse-than-expected economic performance in the fourth quarter of 2008 was expected to drag down China's final GDP growth rate for 2008 to only 8.5 percent, well below the 11.9 percent GDP growth in 2007 and the 10.4 percent growth in the first half of 2008. Yet, Liu said, the first quarter of 2009 would even be worse. The Chinese Leadership expected, however, that China's economy would start to recover enough during the last half of next year to enable China to meet its target of 8 percent growth for 2009. He further noted that for economic policy planning purposes, the Chinese Government looked to electricity usage and transportation figures among other indices, rather than harder to substantiate GDP numbers.

¶4. (C) Liu said he and other Chinese leaders had been aware

as early as March 2008 that China would face economic difficulties this year. Liu and others had traveled south in the spring to Guangdong Province and elsewhere to assess signs that a slowdown would occur. Liu said Guangdong Party Secretary Wang Yang had been among those who saw early the coming problems.

China Expects U.S. to Recover in 2009

¶15. (C) VM Liu noted that the China's economic leaders believe the U.S. economy has already bottomed out. They believe the U.S. has taken very strong actions that have stabilized the situation. Next year, they expect U.S. growth to be flat in the first half, before beginning a gradual recovery in the second half.

Leadership Focused on Urban Centers

¶16. (C) VM Liu said that China's leadership had debated in recent months whether the economic slowdown posed a greater risk to stability in the rural or urban areas. Consensus had been reached that urban unrest would pose a more urgent threat. Thus, the leadership's economic stimulus measures would be primarily focused on easing the impact of the global economic slowdown on China's urban areas. Liu contended that the urban focus includes a focus on China's burgeoning middle-class and their consumption patterns. Liu noted that some of the Party elders continued to assert that the global financial crisis and the impact on China had proven that

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China's reform policies of the past 30 years were mistaken. Liu, however, dismissed these views as a small minority.

More to Come on Stimulus

¶17. (C) Noting that China's leadership remained instinctively conservative, Liu said it had so far only approved a portion of the economic stimulus measures that had been proposed. Liu expected that more of these measures would be necessary and would be approved as the economy continues to slow rapidly in the first quarter of next year and beyond. He did not provide details on the nature of other proposed stimulus measures.

Property Rights Key to Rebalancing

¶18. (C) In discussing China's need to rebalance its economy and stimulate domestic consumption, Liu said that the heart of China's reforms needs to be protection of property, including intellectual property. Chinese consumers were reluctant to spend and consume because they were frightened over their economic security. Liu believed this insecurity derived from a lack of confidence that accumulated wealth and property would be protected and that people would be able to enjoy the fruits of their labor and ideas.

Cannot Succeed Without Political Reform

¶19. (C) Looking past the near-term priority of managing the economic slowdown and avoiding instability, VM Liu volunteered that China would not be able to achieve its long-term goals without political reform. Liu said that Wang Yang and other younger leaders were actively discussing this issue. While all agreed that China's economic policies of reform and opening are on the right track, they saw that there was a need for more democratic input into the policy process, such as involving choices of priorities: whether to emphasize labor or capital in economic policies.

Comment

¶10. (C) VM Liu is one of China's most important economic thinkers and he has significant influence and access to the senior leadership. For example, he noted to the Ambassador during the discussion that he had spent two hours in discussion with Vice Premier Wang Qishan earlier that same day. Having just come out of the key Central Economic Work Conference earlier this month, Liu's views likely reflect the analysis and policy proposals under review by the Chinese leadership. Liu's comments about the leadership's focus on urban stability track with recent public and private comments by other senior Chinese leaders that suggest they may be more concerned about graduating university students not finding jobs than about the return of migrant workers to the countryside.

Randt